

No. 14,953.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JOHN O. ENGLAND, trustee of the Estate of DANIEL E.
SANDERSON, Bankrupt,

Appellant,

vs.

DANIEL E. SANDERSON, Bankrupt,

Appellee.

BRIEF OF AMICUS CURIAE.

FRANK C. WELLER,
HUBERT F. LAUGHARN,
C. E. H. McDONNELL,
THOMAS S. TOBIN,
(CRAIG, WELLER & LAUGHARN),
111 West Seventh Street,
Los Angeles 14, California,
Attorneys, Amicus Curiae.

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BRIEF OF AMICUS CURIAE.

We have been permitted to appear in the within Appeal as *Amicus Curiae*.

We respectfully urge (and are confident we can demonstrate) to this Court that the United States District Judge erred in affirming the Referee's Order in setting apart the homestead upon the basis of the \$12,500 exemption.

Principle of Uniformity of National Bankruptcy Act.

Basically the National Bankruptcy Act provides for uniformity in the treatment of creditors. It likewise provides for the exemption to which the bankrupt is entitled (Sec. 6). This objective is reached by the provision that the right to exemptions are those prescribed by the law of the United States or *State Law*, and thus there is a uniformity provided, at least within the boundaries of the several states.

Treatment of Exempt Property in Bankruptcy Administration.

The property which is eventually set aside to the bankrupt as exempt, obviously does not become a part of the bankrupt estate. (Sec. 70a of the National Bankruptcy Act.)

In connection with the homestead exemption problem, however, there is sometimes involved an administration of the real property upon which the bankrupt has a valid homestead exemption wherein the valuation exceeds the homestead valuation to which the bankrupt is entitled. The Bankruptcy Court, after establishing the amount of the homestead exemption, must administer for the benefit of creditors the surplus. It sells the property and sets aside to the bankrupt his established exemption in cash. The procedure adopted by the Bankruptcy Court and approved by the title companies in the passage of title is synchronized to the provisions of the California Civil Code, Title 5, Chapter 1, Sections 1237 to 1261. (*Blood v. Munn*, 155 Cal. 228.)

The bankrupt, in order to retain his home in lieu of the cash exemption is permitted to pay into the Bankruptcy Court the cash representing the non-exempt portion thereof.

Russell v. Laugharn, 20 F. 2d 295.

The writer of this brief acted as trustee in the bankruptcy proceeding involved in the said appeal and the Court established the rule referred to which has been a directive in many subsequent administrations:

“It would seem unnecessarily harsh to require the property to be sold if the bankrupt is willing to pay to the trustee the net value of her non-exempt interest. . . .”

We have encountered cases in which a division of the property brought about the same equitable result.

We cannot with a generalization say that the Bankruptcy Court is not involved in the administration of homestead property. For an example: Let us take a residence with a sale's valuation of \$50,000, with the bankrupt's homestead exemption of \$7,500 or \$12,500 or any other lesser amount. This problem has many times confronted the bankruptcy administration, although we know of no decision other than *Russell v. Laugharn, supra*, which has reached the appellate court. The bankruptcy court is the only court which has jurisdiction (Sec. 2(11) of the National Bankruptcy Act). On the one hand, it must set aside the exemption to the bankrupt to which he is legally entitled, and on the other, it must administer and distribute to creditors the non-exempt portion of the property.

California Homestead Exemption.

The homestead exemption to the head of a family was increased from \$7,500 to \$12,500 on September 15, 1953. The homestead is secured by the recordation of the Declaration of Homestead.

The Appellee has set forth rather extensively in his brief the case of *Brandt v. Mayhew*, 218 Fed. 422, with extensive quotations and excerpts therefrom. This case of the United States Court of Appeals for the Ninth Circuit's decision in 1914 determined that Section 6 (the exemption section of the National Bankruptcy Act) was paramount and that the same was mandatory. The section requires that there be set aside to the bankrupt the exemptions provided by the state of his domicile at the instant

of bankruptcy. It determined that the rights of the creditors under the state law and/or the rights of the trustee under the provisions of Section 47a (now 70c) could not effect or impede the right of exemption. The argument which was there unsuccessfully advanced to the appellate court in *Brandt v. Mayhew*, was rejected, to-wit: from page 426:

“The petitioner contends that the right which the bankrupt would have to a homestead exemption under the bankruptcy law before the amendment of June 25, 1910, is taken away by that amendment, which adds to section 47a(2) the following:

“‘And such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings thereon, and also, as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a judgment creditor holding an execution duly returned unsatisfied.’”

This rule of law was followed for many years in this Circuit. Then we had the case of *White v. Stump*, 266 U. S. 310 (1924), which reversed a judgment of the United States Court of Appeals for the Ninth Circuit and determined that the Declaration of Homestead should be filed before the filing of the bankruptcy petition.

This case determined the point upon the “line of cleavage” theory. The United States Supreme Court in 1943 in the case of *Myers v. Mattley*, 318 U. S. 622, determined that under the Nevada law, the homestead could be selected at any time before actual judgment execution sale and therefore the trustee’s rights and

powers under Section 70c could not bar the exemption. From page 624:

“The trustee, as to all property in possession and under the control of the bankrupt at the date of bankruptcy, is deemed vested as of that date, with all the rights and remedies of a creditor then holding a lien thereon by legal or equitable proceedings. . . .” (Sec. 70c.)

The rights of the trustee under Section 70c (formerly 47a) do not deal alone with “fraud” as Appellee asserts. Instead the section grants to the trustee a status of a creditor with a lien on the property by legal (or equitable) proceedings as delineated in *White v. Stump*, *Sampsell v. Straub*, and the many other cases interpreting the said section.

We then come to the original case of *Sampsell v. Straub*, 189 F. 2d 379 (of this Circuit). The rule of *Myers v. Mattley*, was followed. However, upon rehearing the Court, took full cognizance of the rights and powers of the trustee under the provisions of Section 70c with respect to homestead exemptions, and reversed its former determination. (*Sampsell v. Straub*, 194 F. 2d 228—Writ of Certiorari denied, 1952.) In giving full recognition to the trustee’s rights and powers, the court determined that in California the Declaration of Homestead must be filed before the bankruptcy proceeding.

Obviously the point involved in these cases is not the identical point here before the Court. We have taken the liberty of digressing on this subject in order to call to the attention of the Court the development of the law with respect to the trustee’s rights and powers under Section 70c in matters pertaining to Section 6 and particularly in connection with homestead exemption.

In order to clarify our argument, we will immediately exclude from our consideration that type of claim, where by contract, the bankrupt waives his exemption. We would like to observe however, that such waiver has been declared to be against public policy in California. (*Industrial Loan and Investment Company of San Francisco v. The Superior Court*, 189 Cal. 546.) We also exclude those obligations which, both by the law of various states (and under Sec. 1241 of the Cal. Civ. Code), are excluded from the effect of a Declaration of Homestead. We will also exclude a consideration of liens on homestead property.

The Appellee has cited several cases which determine that the Bankruptcy Court in the treatment of homestead exemptions does not concern itself with the treatment of such claims and relegate them to the state court after the exemption is set aside. The cases cited by Appellee with respect thereto have no bearing on the instant problem.

Are Exemption Statutes Retroactive as Against Prior Creditors.

The rule is uniform that the subsequent exemption statute cannot affect the rights of the prior creditors, starting with the case of *Nichols v. Eaton*, 91 U. S. 716, and in California, the recent case of *In re Rauer's Collection Co.*, 87 Cal. App. 2d 248, 196 P. 2d 803.

Statutes establishing exemptions (increasing the amount thereof) are as to existing debts unconstitutional.

W. B. Worthen Co. v. Thomas, 292 U. S. 426;

In re Fox, 16 Fed. Supp. 320. Decision by United States District Judge Leon R. Yankwich, Southern District of California, Central Division. Citing numerous cases.

The Appellee apparently dismissed this point from consideration and contends it was the intention of Congress in passing the National Bankruptcy Act to permit Section 6 to take over and destroy this basic principle. Most certainly there was no such legislative intent. Let us assume we have a bankruptcy estate in which all of the creditors were in existence at the time of the establishment of a new or enlarged exemption. It is hardly conceivable we would then have a result that the rights of those creditors as against the assets, which under the state law were not exempted as against creditors' claims, would nevertheless be exempt because of the advent of bankruptcy. We know of no such decision.

Rights and Powers of the Trustee Under the Provisions of Section 70c.

We now come to a consideration of the sole point involved in this appeal. We have a creditor (or creditors) in existence on the date of the enlargement of the exemption valuation.

United States District Judge Edward P. Murphy stated in his Order affirming the Referee's Order on Review, dated October 5, 1955:

"Some of the bankrupt's creditors became such before September 1, 1953, however, and under the law of California, these creditors are restricted only by the amount of the homestead allowance in force at the time of the contraction of the debt, *In re Rauer's Collection*, 87 C. A. 2d 248 (1948) or \$7,500.—The remedy of those creditors whose rights under California law extend beyond the \$12,500 exemption is in the State Courts. Accord, *In re Buckley*, 24 F. Supp. 832 (W. D. La. 1938) (title to property

exempt under state law does not pass to trustee, although creditors held valid waiver of exemption) and cases cited therein at 835. . . .”

Thus we see these pre-existing creditors are directed to go to the state court for the enforcement of their rights as against the increase in the homestead exemption.

Section 70c provides to:

“The trustee, as to all property *whether or not coming into possession or control of the court*, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.” (Emphasis ours.)

It will be noted that this covers “all property in possession of the bankrupt.” Also “*whether or not the same comes into the possession or under the control of the court.*”

We have already demonstrated that this section has a direct applicability to the bankrupt’s exemption and his rights therein. The section has, as against the said property, given to the trustee all of the rights, remedies and powers of a creditor holding a lien thereon. The pre-existing creditors or creditor had no prior levy on the homestead property to reach the non-exempt portion over \$7,500, but they had the right to do so and it was this right which the trustee takes upon and against the non-exempt portion of the said property over and above the former \$7,500 exemption. Obviously a creditor, even without a lien on the homestead property would have superior rights as against the increased exemption. (See the last case of *Sampsell v. Straub*, 194 F. 2d 228, for a discussion of these rights.)

The General Principle of Uniformity and Equal Treatment of the Creditors of the Bankrupt.

We have seen the manner in which the lower court gave treatment to these pre-existing creditors. However, bankruptcy does not dispose of the rights of the creditors of a general class in that manner. Under Section 70c the trustee for the benefit of the whole body of creditors takes this right which the creditor had as to such property, *i.e.* the non-exempt portion.

Our office presented that case of *Moore v. Bay*, 284 U. S. 4 to the United States Supreme Court in 1931. The case came from the United States Court of Appeals for the Ninth Circuit. The decision by Mr. Justice Holmes involved a question pertaining to a void chattel mortgage and the right of distribution to the general body of creditors. From the decision at page 5:

“The trustee in bankruptcy gets the title to all property which—prior to the petition he (the bankrupt) could by any means have transferred *or which might have been levied upon and sold under judicial process against him.* . . . What is thus recovered for the benefit of the estate is to be distributed in ‘dividends of equal percentum on all allowed claims.’” (Emphasis ours.)

Under that decision the trustee took title to property which might have been levied upon and sold under judicial process by creditors. Obviously the pre-existing creditors under California law could have levied upon this homestead property to reach the exemption beyond the amount of \$7,500. This is the right which the trustee takes for the benefit of all creditors.

There Passes to the Trustee as an Asset That Portion of the Property Which Was in Excess of the \$7,500 Exemption.

Under the pronouncement as contained in *Moore v. Bay*, many thousands of bankruptcy administrations have been regulated. The assets transferred or lien on which was void or unenforceable as to anyone of the creditors, was brought into the bankruptcy administration for the benefit of the entire body of creditors and not for the benefit of the single creditor whose right the trustee acquired.

Conclusion.

We respectfully submit that the decision of Referee Wyman and of United States District Judge Edward P. Murphy should be reversed:

1. The bankrupt is entitled to a homestead exemption with a \$7,500 valuation.
2. The trustee has the right of the pre-existing creditors as against the whole property in possession of the bankrupt and the increased exemption is therefore not allowable against the trustee; that Section 6 does not supersede, control or eliminate the right of the trustee under Section 70c.
3. The trustee for the benefit of all creditors is entitled to receive in the bankruptcy administration the surplus valuation over and above the said exemption and to that extent and for that purpose the bankruptcy court should set aside the exemption to which the bankrupt is entitled and administer the surplus of the homestead property.

4. Accordingly the pre-existing creditors should not be permitted to or should not be directed to go into the state court for settlement of their rights as against the homestead property to reach the valuation beyond the amount of \$7,500.

Respectfully submitted,

FRANK C. WELLER,
HUBERT F. LAUGHARN,
C. E. H. McDONNELL,
THOMAS S. TOBIN,
(CRAIG, WELLER & LAUGHARN),
Attorneys, Amicus Curiae.

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